

ORIGINALDecision No. 58793

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of)
 SOUTHERN COUNTIES GAS COMPANY OF)
 CALIFORNIA for an increase in gas)
 rates under Section 454 of the Pub-)
 lic Utilities Code to offset the)
 higher price to be paid to its sup-)
 plier, El Paso Natural Gas Company.)

Application No. 40958

(Appearances and witnesses
 are listed in Appendix A.)

INTERIM OPINION

Applicant's Request

Southern Counties Gas Company of California¹ filed the above-entitled application on March 20, 1959 and requests authority to increase gas rates by approximately \$4,720,000 to offset the annual increase in cost of out-of-state gas scheduled to begin August 1, 1959. Such an increase will result from the increase which the El Paso Natural Gas Company will charge applicant pursuant to new rates filed with the Federal Power Commission (FPC) under Docket No. G-17929. Applicant also requests:

1. Authority concurrently to incorporate permanently into its base rates previous offset charges as related to FPC Docket Nos. G-2016, G-2018, G-4769 and G-12948.

2. Authority to file annually any appropriate adjustment to the offset rate because a long period of time may elapse before

¹ Hereinafter referred to as applicant, is engaged in the business of purchasing, distributing and selling natural gas at retail and wholesale as a public utility to more than 675,000 customers in Southern California. San Diego Gas & Electric Company is applicant's only wholesale customer. About two thirds of applicant's supply of natural gas is purchased from El Paso Natural Gas Company.

Docket No. G-17929 is adjudicated and permanent rates fixed, when otherwise substantial over-collections or under-collections might result.

3. Approval of the method of calculating the amount available for refund and the proposed method of distributing such refund.

The proposed annual increase of \$4,720,000 represents 4.9 per cent of the test year (12 months ending July 31, 1960) revenue from gas sales of \$96,342,000 at present rate levels, as estimated by applicant.

Public Hearing

After due notice, six days of public hearing were held on this application before Examiner Manley W. Edwards during the period of April 21, 1959 to June 19, 1959. All days of hearing were held in Los Angeles except for May 27 and 29 which were held in San Francisco. Applicant presented 17 exhibits and testimony by 6 witnesses in support of its request. Testimony and/or exhibits were presented on behalf of the City of Los Angeles, the San Diego Gas & Electric Company, the California Manufacturers Association and the Negro Masons. In addition, letters were received from several customers urging the Commission not to grant the requested increase. The Commission staff cross-examined applicant's witnesses, presented 7 exhibits and testimony by 5 witnesses for the purpose of developing a full record to aid the Commission in determining applicant's request.

Because staff's Exhibits Nos. 38 and 39 on cost of service were presented late in the hearing, it was contended by applicant that there would be inadequate time to analyze and cross-examine on these exhibits and obtain final rate relief by August 1, 1959. Applicant requested that the matter be submitted for an interim decision and that the final decision be held in abeyance pending further consideration of the staff's cost-of-service study. The

request of applicant was granted. Closing statements were made on June 19, 1959 and the matter now is ready for interim decision.

Applicant's Position

In this proceeding applicant requests permission to recover only the 3.6 cents per Mcf increase in cost of imported natural gas which will result from the higher rates starting August 1, 1959. Applicant does not seek to improve its earnings position in this proceeding and desires only to maintain the earnings position it would have experienced in the test year had the present rates of El Paso continued in effect. Applicant represents that even with this offset increase, it will not earn the 6.5 per cent rate of return authorized by this Commission in Decision No. 55579, the applicant's latest general rate case.

Applicant represents that it has been diligent in opposing any unreasonable increase in natural gas rates before the Federal Power Commission by protesting and participating in proceedings, and has actively opposed not only the rate increases filed by El Paso, but also by El Paso's principal suppliers of natural gas in the field. Applicant's general position is that its present earnings under present rates are not at a level which will permit it to absorb any of the proposed increase, that El Paso's rate increase is contingent upon a final determination of reasonableness by the FPC, and that any excess charges will be refunded to applicant, which in turn will make an appropriate refund to its California customers.

Earning Position

Applicant presented summaries of its earnings position for the calendar years 1956, 1957 and 1958 as recorded, and for 1958 on an adjusted basis (to give effect to average conditions of temperature and to abnormal items on an average basis) and for the year ending July 31, 1960 on an estimated average basis at present and

proposed rates and with the increased cost of gas. Such earnings are shown by Exhibit No. 3 and may be summarized as follows:

	<u>Rate of Return</u>
Year 1956 Recorded	5.58%
Year 1957 Recorded	5.02
Year 1958 Recorded	5.43
Year 1958 Adjusted (Present Rates)	6.04
Test Year, 12 Months Ending July 31, 1960, Estimated:	
Present Rates	4.64
Proposed Rates	5.87

Applicant's estimate for the test year 1959-60 is shown in more detail in Table 1 herein. The Commission staff reviewed the summaries of earnings and work papers of the applicant, made independent estimates of certain items of revenues and expenses, and where warranted, made adjustments to applicant's summary for the estimated year 1959-60. The results of the staff's adjustments are summarized in Exhibit No. 31 and show rates of return for the 12 months ending July 31, 1960 of 4.78 per cent under present rates and 6.04 per cent under proposed rates.

The staff's computation, as well as the applicant's, was on the basis of straight-line tax depreciation accounting and did not show the effect of accelerated depreciation.² The staff's adjustments allowed for a greater average-year usage than applicant, allowed for wages on the basis of latest known increases of 5½ per cent on April 1, 1959 and the applicant's approved increase of 4 per cent on April 1, 1960 for a full year, whereas the applicant reflected only an estimated 5 per cent increase on April 1, 1959

² The question of what rate treatment should be accorded to accelerated depreciation options for income tax purposes is being studied by the Commission under Case No. 6148, but has not been decided as yet. Following decision thereon the Commission will promptly move to make any rate adjustment that may appear warranted.

SUMMARY OF EARNINGS FOR 12 MONTHS ENDING JULY 31, 1960
SOUTHERN COUNTIES GAS COMPANY OF CALIFORNIA
 (At present rate levels and increased cost of gas)

	<u>Applicant's Estimate</u>
<u>OPERATING REVENUES</u>	
General Service	\$ 63,542,000
Gas Engine	486,000
Firm Industrial	2,413,000
Interruptible Service	
Regular Industrial	7,809,000
Steam-Electric Plants	7,571,000
Wholesale, San Diego Gas & Electric Co.	14,521,000
Other Gas Revenues	
Rent from Gas Property	191,000
Servicing of Customers' Installations	45,000
Miscellaneous Gas Revenues	543,000
Total Operating Revenues	97,121,000
<u>OPERATING EXPENSES</u>	
Production	\$ 51,977,000
Transmission	3,640,000
Distribution	5,504,000
Customers' Accounting and Collecting ..	4,484,000
Sales Promotion	2,823,000
Administrative and General	4,725,000
Taxes, Other than Income	6,420,000
Taxes, Income	4,528,000
Depreciation (Annuity and Interest) ...	4,922,000
Total Expenses	89,023,000
<u>NET REVENUE</u>	8,098,000
<u>RATE BASE</u> (Depreciated)	174,389,000
<u>RATE OF RETURN</u>	4.64%

and an estimated additional 4 per cent for the period only from April 1 to July 31, 1960. Also, the staff did not include certain dues and donations and expenditures for political purposes, and did not trend upward the ad valorem tax rate.

Rate of Return

Applicant states that with the proposed offset rates in effect, the rate of return for the test year 1959-60 of 5.87 per cent on a depreciated rate base will fall by \$1,098,000 in net revenue to earn the 6.5 per cent rate of return which this Commission determined in the fall of 1957 was a fair return for the future. Applicant now represents that the rate of return required to recover its embedded cost of bonds and short-term loans and to produce 10.20 per cent on common stock equity is 7.25 per cent; however, on its objective capitalization ratios of 45 per cent bonds, 5 per cent short-term loans, and 50 per cent common equity the required rate of return is 7.01 per cent. Based on this data, applicant computes by Exhibit No. 25 that a rate of return of 6.89 per cent on its depreciated rate base is now fair and reasonable. Therefore, applicant represents that its proposed offset increase is needed in full and is needed promptly. However, it is not seeking to improve its earnings position by this proceeding.

In support of a 10.2 per cent return on equity capital, applicant's financial witness referred to Exhibit No. 22 wherein he showed that seven large natural gas distributing companies in the United States having common stocks in the hands of the public with equity ratios of approximately 40 per cent on the average, with gross revenues in excess of \$30,000,000 annually, earned an average of 12.1 per cent on common stock equity for the five years 1954-58. Inasmuch as the applicant's equity ratio position is about 50 per cent, this witness concluded that since this was higher than for

the test companies, a 10.2 per cent earning figure should enable applicant to compete on a reasonable basis with these other companies in the nation's capital markets for funds. However, on reviewing Exhibit No. 22 the Commission observes that the average equity earnings of the test companies dropped from 12.9 per cent in 1956 to 11.9 per cent in 1958.

The City of Los Angeles, by Exhibit No. 18, confirms this down trend in the earnings requirement on common equity between 1956 and 1958 and by Exhibit No. 19 computes an earnings requirement on applicant's common stock equity in the range of 9.20 to 9.35 per cent. The City urged that the 6½ per cent rate of return last allowed the applicant be found excessive and that the allowed rate of return be fixed in accordance with the City's evidence. The City alleged that a rate of return of even 6.47 per cent would be at the upper end of the range of reasonableness.

Exhibit No. 32, presented by the Commission staff, shows that the present-day embedded cost of bond money is 3.62 per cent, and taking into consideration the \$15,000,000 issue of bonds contemplated in early 1960, and assuming an interest rate of 4.75 per cent on such bonds, the average effective interest rate on all bonds will increase to 3.80 per cent. Looking back to 1957 when the Commission allowed applicant a 6.50 per cent rate of return, the embedded cost of bond money was approximately one half of one per cent below the 3.80 per cent expected in 1960. That the embedded cost of bond money has increased since 1957 is not decisive of the issue of rate of return. The Commission does not rely solely on financial requirements in determining the level of such return. The lawful interests of both consumer and investor must control the rate of return. While the rates of return flowing from the results of operation presented by the applicant and as adjusted by the staff, based on the proposed rates, do not exceed the rate of return heretofore found reasonable for this applicant, we do not consider such rates of return confiscatory. If

the proposed increase of \$4,720,000 is applied to the rate base and operating results as set forth in Table 1 herein, as adjusted by the staff, which we hereby adopt as reasonable, it does not indicate a rate of return that exceeds 6.5 per cent. We find and conclude that the total offset increase of \$4,720,000 for the estimated 12 months ending July 31, 1960 is fully justified. We now return to applicant's proposed spread of the increase, ✓

Rate Spread Proposal

To compensate for the 3.6 cents per Mcf increase in the cost of out-of-state gas starting August 1, 1959, applicant proposes that the base rates in all of its rate schedules be increased in amounts varying between 1.5 cents and 3.6 cents per Mcf in the manner summarized below:

<u>Class of Service</u>	<u>Rate Schedule</u>	<u>Consumption Blocks</u>	<u>Amount Per Mcf</u>
General Service	G-1 thru G-26	First 100 Mcf	3.6¢
	G-1 thru G-26	Over 100 Mcf	2.4¢
Gas Engine	G-45	Rate X, Dec.-Mar.	3.6¢
	G-45	Rate X, Apr.-Nov.	2.0¢
	G-45	Rate Z, Apr.-Nov.	2.0¢
Firm Industrial	G-40, G-41	First, 100 Mcf	3.6¢
	G-40, G-41	Over 100 Mcf	2.4¢
Interruptible Industrial	G-50	First 10,000 Mcf	3.4¢
	G-50	Over 10,000 Mcf	2.2¢
Steam-Electric Plants	G-54	All blocks	1.5¢
Wholesale, San Diego Gas & Electric Co.	G-60	Regular Commodity	2.95¢
	G-60	Off-peak Excess	1.5¢

Among the several factors considered by the Commission in spreading of rates are: (1) the cost to render the service; and (2) the value of the service. Evidence was presented on both of these factors.

Cost of Service

Applicant utilized an independent consulting engineer for the purpose of preparing a cost-of-service study. By Exhibit No. 8 he computed that only the general service shows a rate of return below the system average and that the gas engine, firm industrial and interruptible classes of regular interruptible, and steam-electric and cement plants and wholesale service to San Diego Gas & Electric Company show rates of return above the system average. The California Manufacturers Association also presented a cost study and by Exhibits Nos. 34 and 35 computes that only the general service class shows a revenue deficiency and that all of the other classes show a revenue excess compared to the cost to serve, as its engineers figure it. These two cost studies are predicated on the peak responsibility theory and utilize the abnormal peak day or system design peak capacity to segregate the demand costs or fixed charges as between the several classes of service.

The Commission staff introduced a cost study by Exhibits Nos. 38 and 39 that indicated class cost relationships in general just the reverse of those shown by the other two cost studies in this record, except for firm industrial. The staff's study was predicated on the use that each class made of the system facilities and essentially spread the facility costs among the classes on a noncoincident basis in ratio to the maximum monthly sales to each class. Several parties contended that the staff's method was improper because it did not give consideration to the fact that the interruptible classes do not have demand rights and are largely off-peak services. The staff's exhibits were presented late in the hearing and the parties desired more time to study and prepare additional cross-examination. Applicant requested an interim decision and time later to argue the merits of the staff's study

before the Commission in bank. Several parties appealed to the Commission from the Examiner's ruling that the staff's Exhibits Nos. 38 and 39 be received in evidence, such parties contending that said exhibits are not admissible in evidence.

The Commission has carefully considered the position of the applicant and the several parties with regard to the staff's cost study and since only an interim decision will be rendered herein until a final Federal Power Commission order is rendered in Docket G-17929, there will be ample opportunity to give further consideration to the staff's cost study prior to final decision herein.

Value of Service

Applicant introduced Exhibit No. 26 for the purpose of showing that the costs of competitive fuels in general are higher than the costs of gas for an equivalent number of heat units; however, the costs of heavy fuel oil for certain customers may be lower. Said exhibit shows that for the domestic, commercial, and small industrial customers, when gas is used mainly for water heating, cooking and space heating, the cost of electricity is 1.50 to 3.92 times as great as gas; and the cost of light fuel oil delivered to the customer's tank is 1.09 to 2.63 times as great, exclusive of the added costs of maintaining a fuel oil pump and fuel oil storage tank. For industrial customers, where gas is used as boiler fuel on an interruptible basis, the customer is equipped to burn heavy fuel oil when the delivered price of the oil may be lower than the cost of gas, particularly where the customer can obtain fuel oil below the posted price of \$2.15 per barrel. Recently, the heavy fuel oil market has been in an over-supply condition, prices have been soft, and certain of the larger customers are in position to make spot purchases at sizable concessions from the posted price. The exhibit indicates as much as a 16 per cent lower cost for fuel oil in such conditions.

Rate Spread Positions

The San Diego Gas & Electric Company took the position that applicant's proposed rates will show a return greater than 6.5 percent on its sales to San Diego, that San Diego's general service rates are higher than comparable rates for applicant's customers, that San Diego's customers are being asked to pay a subsidy to applicant's customers, that the benefits of the high load factor at which the San Diego system operates and purchases gas from applicant should be retained for San Diego customers and not passed on to others.

The City of San Diego adopted the position taken by the San Diego Gas & Electric Company and stated that most of the gas customers in San Diego do not have oil standby facilities to enable them to take advantage of low fuel oil prices, and that equity requires adjusting downward applicant's proposed rates for San Diego Gas & Electric in such manner as will be a fair treatment to that class of customer.

The California Manufacturers Association did not oppose the rate spread proposal of the applicant for the schedules under which its members are served, but introduced its cost study for the purpose of showing that any greater increases in the industrial and interruptible services than proposed by applicant are not warranted, pointing out that fuel oil competition at the higher level of consumption in effect precludes a uniform cents-per-Mcf spread to each of the classes of service.

The City of Los Angeles asserted that it would prefer a straight across-the-board offset charge to all customers as the most appropriate way to pass on the increase, if there were no overriding considerations. However, in light of the evidence adduced concerning the cost of alternative fuels for interruptible service, it conceded that some modification of the across-the-board increase might be

warranted. The City urged that the increases proposed by the applicant in its interruptible rates be the minimum increases for such service which the Commission finds reasonable under the circumstances.

The Southern California Edison Company took the position that the rate of return from the general service class was below average; that the rate of return from interruptible steam-plant service was above average; that there was no value of service limitation upon the firm classes, as in the case of the interruptible classes; and that a revaluation of the interruptible rates away from historical precedent is justified at this time.

The California Farm Bureau Federation did not oppose the offset increases in rates nor the allocation thereof as sought by applicant in this proceeding.

Refund Plan

Applicant proposes to determine refund of any overcharge to California customers, as determined by the Federal Power Commission with regard to El Paso's rates, by individual customers in proportion to the amounts of offset charges they have paid during the offset rate collection period; except that as a matter of simplification and to reduce the cost of refunding if the amount refundable to the general service customers averages more than \$1.00 per customer, refunds shall be made to active customers on the basis of a plan to be submitted after the amount available for refund has been established. If the total amount refundable to such customers averages \$1.00 per customer or less, the refund to such customers shall be made as a uniform credit to each customer's bill.

Findings and Conclusions

After considering the evidence of record, the Commission finds and concludes that:

1. Applicant's present earnings position, after fully accounting for growth in customers, sales, and revenues, is at such a level that

it is not reasonable to ask the applicant to absorb any of the increased cost of out-of-state gas.

2. Since this is only an interim order, and since applicant's proposed increased rates mostly are below the level of competitive fuels and are subject to refund of any overcharge pending final Federal Power Commission action on El Paso's increased rates for gas, applicant's proposed rate increases and rate spread appears realistic, practical, and reasonable in the circumstances.

3. Gas for most purposes is a superior fuel, but in certain instances where heat units only are considered, the lower increases for interruptible customers as compared to firm rates are designed by applicant at this time to minimize the loss of the interruptible business.

4. An order should be issued granting the applicant's rate increase requests on an interim basis, but withholding decision on applicant's other requests at this time.

5. The rates and charges authorized herein are justified and existing rates, in so far as they differ therefrom, for the future are unjust and unreasonable.

The increases being authorized, segregated by classes of service, under applicant's estimates of sales for 1959-60 are:

<u>Class of Service</u>	<u>Sales Mcf</u>	<u>Revenue Present Rates</u>	<u>Revenue Increase Amount</u>	<u>Ratio</u>
Firm Service				
General Service	70,979,500	\$63,542,000	\$2,494,000	3.9%
Gas Engine	1,072,500	486,000	25,000	5.1
Firm Industrial	4,336,300	2,413,000	120,000	5.0
Wholesale* (S.D.G. & E.Co.)	39,336,100	14,521,000	1,159,000	8.0
Subtotal Firm	<u>115,724,400</u>	<u>80,962,000</u>	<u>3,798,000</u>	<u>4.7</u>
Interruptible Service				
Regular Industrial	20,700,300	7,809,000	587,000	7.5
Steam-Electric Plants	22,328,800	7,571,000	335,000	4.4
Subtotal Interpt.	<u>43,029,100</u>	<u>15,380,000</u>	<u>922,000</u>	<u>6.0</u>
Other Gas Revenue	-	779,000	-	-
Totals	<u>158,753,500</u>	<u>97,121,000</u>	<u>4,720,000</u>	<u>4.9</u>

* Includes some interruptible sales by San Diego.

The Commission again calls to the attention of the applicant its duty to vigorously resist all proceedings before the Federal Power Commission which involve gas rates affecting California, to the end that the interests of the customers of the California utilities will be fully protected.

The Commission is also gravely concerned that the instant increase, all of which occurs in the commodity component at the state line, dollarwise is assigned more to the firm user because of the showing at this time of potential loss of interruptible load had uniform amounts of increase in cents per Mcf been placed in the interruptible classifications. Applicant is placed on notice that this is an interim decision and a redistribution can be considered should changed conditions, including competitive fuel costs, warrant such treatment pending final decision by the Federal Power Commission. Applicant should also intensively survey and consider additional underground storage facilities or other means of serving its customers, in the light of the trend of increasing source cost of gas, and the apparent inability to fully pass such increases on to large interruptible customers, at least at the present time.

INTERIM ORDER

Southern Counties Gas Company of California having requested offset increases because of increases in the cost of out-of-state gas, public hearing having been held, the Commission having found that increases in rates and charges are justified, the matters having been submitted for an interim decision pending further analysis of and cross-examination on Exhibits Nos. 38 and 39, and now being ready for decision; therefore,

IT IS ORDERED as follows:

1. If the Federal Power Commission allows El Paso Natural Gas Company to increase its rates for natural gas to applicant by 3.6 cents per Mcf effective August 1, 1959, then applicant hereby is authorized to file in quadruplicate with this Commission, in conformity with General Order No. 96, revised schedules with changes in rates, terms and conditions in such schedules as set forth in Exhibit B of Application No. 40958 and after not less than one day's notice to this Commission and to the public to make said revised rates effective for service rendered on and after the date the increased El Paso rates, lawfully, go into effect.

2. In the event that applicant places such rate increases in effect:

- a. Applicant shall keep records of sales to customers during the effective period of this cost of gas offset rate as will enable it to determine readily the total offset charge and the total refund, if any, that may be due each customer.
- b. Applicant's plan for determining refunds shall be submitted to this Commission prior to making any refunds, and specific Commission approval shall be obtained of the plan at that time.

- c. When the decision by the Federal Power Commission in Docket No. G-17929 shall have become final, applicant shall file a supplemental application herein containing its proposed permanent rate plan for final determination and authorization by this Commission.
- d. Upon final determination of the actual cost of refunding not recovered from El Paso and the amount of any balance created by applicant's inability to deliver checks and by checks uncashed after one year, applicant shall file a plan acceptable to the Commission for the equitable disposition of the resultant net balance.
- e. Applicant shall file with the Commission monthly reports within sixty days following the close of each monthly period, setting forth:
 - (1) The increase in revenues realized under the offset rates authorized herein, segregated by firm and interruptible classes of service, and
 - (2) The increase in cost of out-of-state gas above the rate level in effect immediately prior to the date on which the proposed El Paso rates go into effect.
- f. Applicant shall continue to show in its tariffs the amounts of offset charges included in the several rates that may be subject to refund, and should revise the statement to include the dates from which such offset amounts are effective.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 22nd day of July, 1959.

Everett R. Rogers
President

Matthew J. Cook

Theodore H. Turner

Commissioner C. Lynn Fox, being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A

LIST OF APPEARANCES

For Applicant: Milford Springer and Robert M. Olson, Jr.

Interested Parties: R. E. Woodbury and Harry W. Sturges by C. W. Wiley, for Southern California Edison Company; Chickering & Gregory by Sherman Chickering and C. Hayden Ames and Frank Porath, for San Diego Gas & Electric Company; T. M. Chubb, Robert W. Russell and Manuel Kroman, for Department of Public Utilities and Transportation, City of Los Angeles; Alan G. Campbell, Assistant City Attorney, for City of Los Angeles; Henry E. Jordan, for Bureau of Franchises and Public Utilities of the City of Long Beach; Walhfred Jacobson and Leslie E. Still, for City Attorney's Office, City of Long Beach; Brobeck, Phleger & Harrison by Robert N. Lowry, for California Manufacturers Association. Ralph Hubbard and William Knecht, for California Farm Bureau Federation; W. D. MacKay (Commercial Utility Service), for Exchange Orange Products Division, Ontario, California; J. F. DuPaul, by Frederick B. Holoboff, for City of San Diego (Intervenor).

Commission staff: Martin J. Porter and Jean Balcomb.

LIST OF WITNESSES

Evidence was presented on behalf of the applicant by: Cecil L. Dunn, J/ Q. Abel, John E. Jensen, Roy A. Wehe, John C. Abram, Homer R. Ross.

Evidence was presented on behalf of the interested parties by: Manuel Kroman, William W. Eyers, Lewis R. Knerr, William L. Wood.

Evidence was presented on behalf of the Commission staff by: Charles R. Currier, George C. Doran, Robert O. Randall, P. E. Valena, Louis W. Mendonsa.